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C O N F I D E N T I A L SECTION 01 OF 03 RIYADH 002057

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DEPT OF ENERGY PASS TO MWILLIAMSON, AHEGBURG, GPERSON, AND
JHART

E.O. 12958: DECL: 10/07/2017
TAGS: EPET ENRG ECON SA
SUBJECT: SHELL ON GAS EXPLORATION AND MOTIVA EXPANSION

REF: RIYADH 422

Classified By: ECONOMIC COUNSELOR ROBERT BARRY
MURPHY FOR REASONS 1.4 B, D, AND E

Summary

¶1. (C) In an October 1 conversation, Chairman of Shell Companies in Saudi Arabia, Robet Weener, provided updates on the status of Shell's gas exploration efforts in the Rhub al Khali (RAK) region, as well as the late September final investment decision (FID) to move ahead on the expansion of the Motiva refinery in Port Arthur, Texas. On gas exploration, Weener emphasized the challenges ahead in prospecting such large concession. While Weener appears sure there is natural gas in the RAK, he appears far less confident that Shell will succeed in locating it during the remaining two years of its concession. He deplored the waste of natural gas taking place in the KSA because of artificially low gas prices. Weener emphasized that Shell was confident in the project economics of the Motiva expansion, as most of the construction contracts were already locked in. The Motiva expansion will allow Saudi Aramco to ship increasingly heaver crude to the US for refining. The FID is one step in beginning to redress the world's shortfall in heavy crude refining capacity.

SRAK Struggles to Cope with Vast Concession

¶2. (C) Weener reiterated that the Shell carries out its RAK gas exploration work through its interests in the South Rhub Al-Khali Company (SRAK), a joint venture in which Shell holds 40 percent equity, and Saudi Aramco and Total hold 30 percent each. He stated SRAK had a 200,000 square kilometer concession, remarking, "it's a huge area, the size of the UK, and ten times the size of the three other Rhub Al-Khali gas concessions." Weener noted the difficulty of starting with so little data in such a vast exploration tract, saying when they first began work, SRAK "pretty much had a white sheet of paper, Aramco had hardly any usable data. We've done a

lot of seismic, run a lot of technical data."

¶3. (C) However, in such a vast region, the challenge for SRAK is to determine whether their models are correct. "We're pretty sure there is oil and gas in the RAK, there is oil and gas on the borders there with Yemen, Oman, and Abu Dhabi. If we're not correct, I wouldn't write off the area, it is just likely that our models may be wrong." For the first exploratory period, which will wrap up in about two years, SRAK has a commitment with Saudi Aramco to drill seven wells, and run 60,000 square kilometers of seismic data, of which about 20,000 are already completed. Weener emphasized, "We'll do our commitments and a bit more." SRAK could and likely will negotiate an extension of the concession. However, Ministry of Petroleum (MinPet) sources have explained that in line with standard international practice, SRAK would have to relinquish half of the acreage at the renegotiation.

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"Your Biggest Gas Field in Saudi Arabia is in the Price"
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¶4. (C) Moving on the issue of gas pricing in Saudi Arabia, Weener noted that Shell had a radical change of perspective when it expanded upstream from the KSA's petrochemical sector, where it was a gas buyer, into upstream gas development, where it will be a gas seller - assuming SRAK makes a gas discovery. Weener remarked, "When we were just on the petrochemical end of the business, we were always very pleased by the cheap price of gas." Laughing at the turn of events, Weener noted, "now that we're in the upstream, we think the price of 75 cents (per million Btu) is ridiculous!

The price is $4-$5 USD in most of the region, and the Rhub al Khali is the most remote and hostile region on earth. The nearest gas processing facilities are 1000 kilometers away." (hence transport costs high)

¶5. (C) Weener wonders how the large number of new gas-based integrated water and power projects the SAG hopes to build in coming years will ever be economically viable with the current gas pricing model, which relies on heavily subsidized sales of gas to the industrial sector. Weener continued, "Price Faisal (HRH Prince Faisal bin Turki bin Abdulaziz Al Saud, Senior Advisor in the Ministry of Petroleum and Mineral Resources), the gas regulator, says that gas prices will go up, but only when the time is ready. He points to the social imperatives of building out power and water supplies first." Weener shook his head, and said, "Our response to Price Faisal is, your cost is so artificially low you're encouraging wastage. Your biggest gas field in Saudi Arabia is in the gas price. Right now, people have an artificial feeling of plenty."

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Desire to Get Saudis to Engage on Climate Change
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¶6. (C) Weener moved on to the issue of climate change, stating he wished he could get the Saudis to engage with industry on the issue. He has tried to make an appointment with Dr. Al-Sabban, the Ministry of Petroleum's lead climate change negotiator, and was told in so many words that the appointment was not available. With a leading role in oil production, Weener believes the Saudis could take on leadership in carbon sequestration research and activities, but right now, they do not appear interested in engaging with industry in these initiatives. Weener noted that both Shell and Chevron had strong corporate positions in favor of engaging on climate change issues. He stated that if industry and the Saudi government did not get out ahead of the public on these issues, they risk "having them turn against us."

Motiva Update: Shell Confident of Project's Economics; Expansion Accommodates Shift Towards a Heavier Barrel

¶7. (SBU) As widely reported in the energy press in late September, Weener confirmed the FID on the Motiva, Port Arthur, Texas refinery, a joint venture between Shell and Saudi Aramco. The expansion will add 325,000 barrels per day (bpd) of capacity to the existing plant, for a total of 600,000 bpd capacity. Weener noted Motiva would be the largest plant in the US after the expansion. Weener stated that the firms had decided to move ahead "even though the construction industry in the US is boiling over, and the project is a cost containment challenge. Even at about $7 billion, it's still economically viable." Weener explained that Shell was highly confident regarding cost containment, because 85 percent of the construction contracts had been tendered and let, locking in prices already."

¶8. (C) Weener explained that the Motiva expansion would accommodate Saudi Arabia's production shift towards a heavier barrel. Weener re-capped that much of the lack of refining capacity in recent years was not so much an overall lack of capacity, as a lack of capacity to process the world's increasingly heavier basket of crude. Motiva's expansion was designed to address this issue. Remarking on the crude supply agreement, he noted that Shell generally lifted Saudi crude for Motiva, but also reserved the option to bring in other crudes. Reserving this option "keeps the Saudis honest," and allowed Shell to bring in occasional excess supply from other regions. Weener expects this general arrangement would continue once the expansion was completed. Aramco refining official Salahaddin Dardeer has indicated that with the expansion, Motiva will be a full conversion refinery, capable of producing products to meet the strictest

U.S. environmental product specifications, such as those in place in California. The primary feedstock will be Arab Heavy crude from Saudi Arabia, but specific fields have not yet been identified. The refinery expansion should be completed by the end of 2010 or early 2011.

Shell Sitting Pretty in Latest Market Turns

¶9. (U) Weener noted that Shell was the largest downstream supplier in the US, and was very pleased at the turnaround in the downstream market. For many years, he noted, the industry questioned Shell's investments in the sector, but "now the tide has turned, and downstream is a great market." He also remarked on Shell's investments in innovative projects such as Canadian tar sands and Colorado oil shale, which seem ahead of their time now, but may prove very profitable in long run.

US Investment Climate, Political Optics, and the Motiva Expansion

¶10. (C) In recent months, MinPet has repeatedly called the expansion of Motiva into question, complaining of a deteriorating investment climate for Saudi Aramco in the US due to expanding ethanol production, and pending anti-OPEC ("NOPEC") legislation and lawsuits. When asked if the Motiva FID reflected any resolution of these concerns, Weener stated, "The US is wonderfully pluralistic, and the Saudis are more used to an orchestrated society. We keep telling them, you can't wish this sort of thing away (e.g., the lawsuits), you just have to equip yourself with sufficient lawyers to keep the other ones at bay. And then life continues. Most of these cases get thrown out eventually anyway. This is fundamentally a cultural problem for the

Saudis to understand." Weener, himself Dutch, continued, "The Saudis have a love-hate relationship with the US. Usually the love is stronger, but they will complain. Right now, they have a real feeling of victimization. They feel that for all they have done for the U.S over many years, they receive too little gratitude. The backlash from 9-11 is part of the problem, Of course, the U.S. is pluralistic, gratitude is not expressed in the same way. And the culture gap is so large."

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